

**Before the
Public Service Commission of Wisconsin**
In re: Petition of SBC Wisconsin for)
Suspension of Wisconsin §196.196(1) with) Docket No. 6720-TI-196
Regard to Basic Local Exchange Service)

**Direct Testimony
Of
Joseph Gillan
On Behalf Of
Citizens Utility Board of Wisconsin**

April 19, 2005

PUBLIC VERSION

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1 **I. Introduction and Witness Qualifications**

2

3 **Q. Please state your name, business address and occupation.**

4

5 A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando,
6 Florida 32854. I am an economist with a consulting practice specializing in
7 telecommunications.

8

1 **Q. Please briefly outline your educational background and related experience.**

2
3 A. I am a graduate of the University of Wyoming where I received B.A. and M.A.
4 degrees in economics. From 1980 to 1985, I was on the staff of the Illinois
5 Commerce Commission where I had responsibility for the policy analysis of
6 issues created by the emergence of competition in regulated markets, in particular
7 the telecommunications industry. While at the Commission, I served on the staff
8 subcommittee for the NARUC Communications Committee and was appointed to
9 the Research Advisory Council overseeing the National Regulatory Research
10 Institute.

11
12 In 1985, I left the Commission to join U.S. Switch, a venture firm organized to
13 develop interexchange access networks in partnership with independent local
14 telephone companies. At the end of 1986, I resigned my position of Vice
15 President-Marketing/Strategic Planning to begin a consulting practice.

16
17 Over the past twenty-five years, I have provided testimony before more than 35
18 state commissions, five state legislatures, the Commerce Committee of the United
19 States Senate, and the Federal/State Joint Board on Separations Reform. I have
20 also been called to provide expert testimony before federal and state civil courts
21 by clients as diverse as the trustees of a small competitive carrier in the Southeast
22 to Qwest Communications. In addition, I have filed expert analysis with the

1 Finance Ministry of the Cayman Islands and before the Canadian Radio-
2 Telecommunications Commission.

3
4 Finally, I serve on the Advisory Council to New Mexico State University's Center
5 for Regulation (since 1985) and serve as an instructor in their "Principles of
6 Regulation" program taught twice annually in Albuquerque. In addition, I lecture
7 at Michigan State University's Regulatory Studies Program. I have also been
8 invited to lecture at the School of Laws at the University of London (England) on
9 telecommunications policy and cost analysis in the United States.

10
11 **Q. On whose behalf are you testifying?**

12
13 A. I am testifying on behalf of the Citizens Utility Board (CUB).

14
15 **Q. What is the purpose of your testimony?**

16
17 A. The purpose of my testimony is to evaluate SBC-Wisconsin's claim (hereafter
18 "SBC") that residential local competition in Wisconsin has developed to such an
19 effective level that the Commission should suspend price regulation for basic
20 local exchange service. As I explain below, I do not believe that the evidence
21 supports a finding of effective competition for residential basic local exchange
22 service at this time.

1 **Q. What are the principal findings in support of this conclusion?**

2

3 **A. The principal findings of my testimony are:**

4

5 * SBC's request to lift price cap regulation on basic local service
6 (BLS) should consider the likely effect on the prices of that service
7 standing alone, i.e. not as a part of a package of services. SBC
8 already enjoys pricing freedom for its packages and today serves
9 more than 60% of its residential customers in that manner. Its
10 request here applies to a narrower group – those residual customers
11 desiring stand-alone BLS which the Commission should evaluate
12 as a distinct market segment.

13

14 * Residential competition is concentrated among few firms, several
15 of which are exiting the market, while others are reporting
16 financial instability that lessens, if not eliminates, their probative
17 value. Many of the lines served by competitors today are the by-
18 product of prior entry decisions that are being reversed.

19

20 * The decay in traditional wireline competition will accelerate as
21 new federal unbundling rules are implemented and two of the
22 largest competitors abandon the residential market, while others
23 incur significantly increasing costs that preclude basic local service
24 offerings.

25

26 * Potential cable-based competition must be evaluated as to its
27 equivalency, geographic scope and, ultimately, by whether a
28 duopoly market structure would satisfy the standards of §196.195,
29 even assuming the services are equivalent.

30

31 * SBC's claims regarding intermodal competition – wireless and
32 VoIP – are inconsistent with its positions before the FCC in its
33 acquisition of AT&T Wireless (by Cingular) and its pending
34 application to acquire AT&T. Evidence does not support the claim
35 that such alternatives play a price-constraining role on SBC's
36 pricing of BLS.

37

1 The core conclusion of my testimony is that residential competition is still too
2 limited to be considered effective, even if one draws no distinction between
3 relatively expensive service-bundles/packages and stand-alone basic local service.
4 However, if the analysis is properly limited to stand-alone basic local service,
5 there is effectively *no* competition in the market at all.

6
7 **Q. Does your testimony follow the outline of Staff's proposed issues list?**

8
9 A. Yes. Although I may not address each of the specific issues, I have generally
10 organized my testimony to follow the Staff's outline. Specifically, my testimony
11 addresses issues concerning the relevant market for the analysis (Section II),
12 before turning to an evaluation of whether there is effective competition (Section
13 III). My testimony then concludes with a discussion of the likely effects of
14 prematurely deregulating SBC and offers recommendations to the Commission
15 (Section IV).

16
17 **II. The Relevant Market**

18
19 **Q. SBC has proposed a geographic market definition of Rate Group A and B**
20 **exchanges. Do you disagree with this geographic definition?**

21
22 A. Although different approaches to the geographic market could be adopted, my
23 analysis indicates that the geographic definition is not particularly important to

1 judging the merits of this particular application. As such, there is little reason to
2 dispute the markets selected by SBC.¹ Rather, my testimony accepts Rate Groups
3 A and B as generally defining the *area* of analysis and I focus my testimony on
4 the more relevant question: i.e., is there effective competition for basic local
5 exchange service which would justify the lesser degree of regulation requested by
6 SBC (i.e., the suspension of price cap regulation)?
7

8 **Q. What do you believe is the relevant product market for the analysis?**
9

10 A. SBC has requested lesser regulation for residential basic local exchange service
11 (BLS). The Commission defines BLS as:
12

13 Basic local exchange service means the provision of a working
14 telecommunications service (i.e., “dial tone”) to residential
15 customers through the furnishing of a primary access facility or
16 line, essential usage within a local calling area for the transmission
17 of high-quality, 2-way interactive switched voice or data
18 communication, and includes EAS, ECC service and necessary
19 residential service order charges.²
20

21 In common terms, BLS is “plain old telephone service” (POTS) that has
22 traditionally been the focus of regulation and universal service policies for
23 decades.

¹ As I explain in my testimony, I do not believe that SBC faces effective competition sufficient to remove price cap protections on basic local service at this time. However, as I explain in the final section of my testimony, should the Commission grant such relief in Rate Groups A and B, it should also require SBC to adhere to such Rate Groups areas in the future and be required to charge the same prices within each exchange of each Rate Group.

² See Issue List, Docket 6720-TI-196.

1

2 **Q. Are there any issues with respect to the appropriate product definition?**

3

4 A. Yes. For some customers, BLS is purchased as a component of a package of
5 communication services that frequently includes long distance service or, less
6 frequently, Internet access (or even video services). Although I believe the
7 evidence in this proceeding will show that competition is generally limited for all
8 residential customers – i.e., whether they purchase stand-alone BLS or packages
9 that include these capabilities – I believe the Commission should focus on BLS as
10 a stand-alone product in judging the merits of this application.

11

12 **Q. Why do you recommend that the Commission should focus on BLS as a**
13 **stand-alone service?**

14

15 A. I believe the relevant market should be stand-alone BLS because it is stand-alone
16 BLS for which SBC is seeking price deregulation. When SBC offers BLS as part
17 of a package, it already has flexibility as to how to price that package. This is true
18 with regard to packages including other features or pricing plans, as well as
19 packages that include other services (such as Internet access or long distance
20 service).

21

22 Any uncertainty as to the regulatory distinction between stand-alone BLS and
23 packages was ended by *Wisconsin Bell v. Wisconsin PSC*, decided November 18,

1 2004.³ That decision concluded that BLS that was sold by SBC as part of a
2 package was not subject to price regulation.

3
4 Moreover, when SBC (or some affiliate) includes BLS within packages that
5 include services that are effectively deregulated (such as Internet access or long
6 distance services), SBC can price the overall *package* in any way that it wants.
7 Because SBC is seeking the suspension of price cap regulation for stand-alone
8 basic local exchange service, I recommend that the Commission focus its analysis
9 on such service as a distinct product market.

10
11 **Q. Are you saying that packages that include BLS are not “the same, equivalent**
12 **or substitutable” for BLS?**

13
14 A. In the context of what §196.195 is requiring here, yes. Whether it was the
15 Wisconsin legislature in 1994 when it adopted §196.196 – or when the Court
16 accepted SBC’s interpretation of that statute in 2004 – the subsequent
17 deregulation of packaged versions of BLS effectively decided this question by
18 creating separate regulatory regimes for each.

19
20 Packaged-offerings have been the primary marketing focus of SBC since (at least)
21 it gained approval to offer long distance services in Wisconsin. Over time, a

³ *Wisconsin Bell d/b/a Ameritech Wisconsin v. Wisconsin Public Service Commission*, Case No. 03-2235, November 18, 2004.

1 process of self-selection has occurred, where customers that view BLS as
2 substitutable for packaged-services do, in fact, substitute these services. In
3 December 2004, nearly *** of SBC's residential customers in Wisconsin
4 subscribed to a bundle that combined local service with either long distance, DSL,
5 wireless or DISH TV, with the number of bundled-subscribers ***
6 during the year by nearly *** *per quarter*.⁴

7
8 The "residual BLS base" has demonstrated a preference to remain on stand-alone
9 local telephone service, and there is no reason to conclude that more expensive
10 packaged offerings that include unwanted features or services are the "same,
11 equivalent or substitutable" to the service they currently purchase. Consequently,
12 I believe that the Commission should evaluate such customers as a distinct
13 market.

14
15 **Q. What do you mean by the term "substitutable"?**

16
17 **A.** I am using the term "substitutable" as a measure of a customer's expected
18 response to a price increase. The economic protection afforded by effective
19 competition is that the demand response to an increase in price ultimately proves
20 unprofitable to the incumbent as carriers shift to alternatives. I believe that term
21 "same, equivalent or substitutable" as used in §196.195, combined with its
22 discussion of market power and comparable rates, is all intend to emphasize the

⁴ December 2004. Sources: SBC Response to 1-CUB-5, and AET-6.

1 ability of competition to provide an effective price-constraining role before price
2 regulation is eliminated.

3
4 Where the prices of packaged offerings are higher than the price of stand-alone
5 BLS, the existence of such packages do not constrain the price of BLS for those
6 customers uninterested in other elements of the package. For instance, if the price
7 of BLS is \$20 per month and a competitor is offering a package that combines
8 BLS with “unlimited” long distance calling for \$50, the unlimited calling package
9 should not be considered the “same, equivalent or substitutable” service to a
10 customer with little long distance calling because such a customer would never
11 actually “substitute” the package for BLS.

12
13 I discuss this concept more extensively later in my testimony where I address
14 whether lifting price cap controls on BLS would be in the public interest. As the
15 Commission reviews the evidence concerning competition in the residential
16 market, however, I believe it should adopt a “product” definition that is limited to
17 stand-alone BLS.

18
19 **Q. Is your conclusion that competition is not effective in the residential market**
20 **dependent upon your view that stand-alone BLS should be evaluated as a**
21 **separate product market?**

1 A. No, my conclusion that there is not effective competition for residential BLS is
2 not dependent upon this product definition. I believe that even a broader review of
3 competitive conditions in the residential market that includes both packaged and
4 basic offerings demonstrates that competition is too limited to be effective, and is
5 highly sensitive to the changing federal policies and the decisions of just a few
6 firms. However, if the analysis is *confined* to competition in the stand-alone
7 market, then the competitive environment is essentially the null set.

8

9

III. Analyzing the Level of Residential Competition

10

11 **Q. Please summarize the level of residential competition claimed by SBC.**

12

13 A. SBC's claims regarding the level of residential local competition have three basic
14 components:

15

16 1. An estimate of traditional wireline local competition
17 (Loehman) developed from SBC billing records and the
18 E911 database;

19

20 2. A "tops-down" estimate of total residential competition
21 (Tattini) claimed to include the effects of intermodal
22 competition; and

23

24 3. A general discussion of intermodal competition (wireless
25 and VoIP) claiming such services should be considered
26 effective substitutes for basic local exchange service.

27

I address each of these areas separately below, explaining deficiencies in the methodology applied by SBC and discussing the probative value of the conclusions they have drawn.

(a) Traditional Wireline Competition

Q. What is SBC's estimate of wireline competition in Rate Groups A and B?

A. SBC's core analysis of wireline competition is developed from its UNE-billing records and an extract from the E911 database. According to SBC, CLECs have gained roughly 26.3% of the residential market (as of September 2004) using the entry strategies shown below.⁵

Table 1: SBC Claims of Wireline Competition⁶

Entry Strategy	CLEC Share
Resale	0.1%
UNE-P	16.1%
UNE-L	7.7%
CLEC Loops ⁷	2.4%
Total CLEC Share	26.3%

⁵ I address whether SBC's methodology is accurate later in my testimony. For my purposes here, I accept SBC data as valid and confine my analysis to its relevancy.

⁶ Sources: JRL-7 (CLEC lines) and JRL-8 (SBC Retail Lines). There is a minor discrepancy of 0.1% between the CLEC share shown above (based on JRL-7) and that shown by SBC on JRL-8. This discrepancy is the result of SBC including all CLEC lines in JRL-8, whereas its analysis in JRL-7 considers only what SBC considers "large" CLECs.

⁷ SBC relies on the E911 database to assert that a number of carriers are serving residential customers using their own loop facilities (in contrast to leasing loops from SBC, either as part of resale, UNE-P or UNE-L). I explain later in my testimony that this assumption by SBC – i.e., that the E911 database demonstrates that CLECs are serving carriers using their own loop facilities – is generally false, thereby inflating SBC's estimates of residential competition.

1 **Q. How should the Commission evaluate whether these statistics demonstrate**
2 **“effective competition” in the relevant exchanges?**

3
4 **A.** The central element of “effective competition” is competition that is price
5 constraining – that is, would an increase in price by SBC cause sufficient
6 customers to leave SBC for alternatives such that the net effect of the price
7 increase would be lower profits. Market share statistics are useful measures of
8 effective competition because they offer insight into the prior decisions of
9 consumers and inform the Commission as to barriers to entry and the ability of
10 competitors to make alternative services readily available at comparable rates,
11 terms and conditions.

12
13 In this instant application, it is useful to look at each of the entry strategies in the
14 context of the standards of §196.195(2), to determine whether such strategies are
15 price constraining (now and in the future), as well as to identify trends and
16 barriers associated with each. As I explain in more detail below, the competitive
17 activity cited by SBC is fundamentally unstable, in large part due to the actions of
18 SBC itself. Specifically:

19
20 * 60% of the claimed competition relies on an entry strategy
21 (UNE-P) that SBC has convinced the FCC to eliminate as a
22 price-constraining force.⁸

⁸ I do not actually agree that SBC can eliminate access to UNE-P, inasmuch as it is required to offer all of its elements under §271 of the federal Act as part of the voluntary obligations it embraced when it began offering long distance services to consumers in Wisconsin.

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* The two largest competitors in the country – AT&T and MCI – are being acquired by RBOCs. Given the critical role these companies played in establishing the baseline conditions for UNE-based competition (UNE-L and UNE-P), the elimination of these competitors calls into question all forms of UNE-based competition.

* Six CLECs are responsible for *** of the residential competition claimed by SBC. Of these six competitors, two have announced plans to abandon the market,⁹ while a third has announced it is trying to sell its company due to the harmful effects of the FCC's actions and the industry concentration that would result from the proposed mergers.

17

18

19

20

21

22

Simply put, although SBC claims that more than 25% of the residential lines are being served by nineteen large CLECs, once the data is evaluated to consider changing federal rules, market abandonment by the largest competitors and recent trends, the actual “competition” is coming from one or two companies, serving a far smaller portion of the market.

23

Q. Why is it important for the Commission to consider “the number and size” of competitors, as well as “any apparent trends” as to how conditions will change in the future?¹⁰

24

25

However, given SBC's persistent litigation on this point, the Commission cannot be assured that UNE-P based competition will continue.

⁹ See AT&T Press Statement *AT&T Announces Second-Quarter 2004 Earnings, Company To Stop Investing In Traditional Consumer Services*, July 22 2004 and MCI Declaration of Wayne Huyard, Application for Transfer of Control, WC Docket 05-075, March 11, 2005.

¹⁰ See §196.195(2)(A)(1) and (5).

1

2 A. For all practical purposes, deregulation is a one-way street. It would be very
3 difficult for the Commission to reassert price regulation on SBC once it is
4 removed.¹¹ The key protection is effective competition, and the key condition
5 needed for effective competition is low barriers to entry. What the Commission
6 should avoid is a finding of effective competition based on the activities of one or
7 two firms that may reflect some unique advantage. In such a circumstance, a
8 change in a single firm's business plan would have significant market-wide
9 repercussions.

10

11 **Q. Are there known changes in competitive conditions that the Commission**
12 **must consider?**

13

14 A. Yes. The most significant change concerns the effect of federal unbundling rules
15 on the most prevalent entry strategy in the residential market, UNE-P. With the
16 exception of a single carrier (TDS Metrocom), more than *** *** of the
17 residential competition in Wisconsin is dependent upon UNE-P.¹² It is UNE-P
18 that reduced entry barriers for competitors *generally*, thereby permitting a broader
19 array of carriers to compete for the residential customer.

20

¹¹ Although the Commission might theoretically order SBC to reintroduce stand-alone BLS, there would almost certainly be litigation concerning rate levels, Commission authority and operational claims regarding billing, provisioning and repair.

¹² Source: JRL-7.

1 **Q. Is UNE-P a stable platform for the offering of competitive local exchange**
2 **services?**

3
4 A. No. The FCC's *Triennial Review Remand Order*¹³ eliminates CLEC access to
5 local switching at TELRIC-based rates. Because switching is used in UNE-P to
6 gain efficient access to local loop facilities needed to serve residential customers,
7 the elimination of local switching will effectively eliminate UNE-P (assuming
8 that the comparable arrangement required under §271 of the federal Act is not
9 implemented quickly).¹⁴

10
11 The elimination of TELRIC-based local switching has already had an immediate
12 impact on the local market. Two of the largest CLECs in Wisconsin (AT&T and
13 MCI, which collectively serve nearly *** *** of the CLEC's residential
14 lines) have already abandoned the consumer market. The following table shows
15 the dependency of residential competition in Wisconsin on UNE-P.

¹³ *In the Matter of Unbundled Access to Network Elements*, WC Docket No. 04-313, *Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Order on Remand (released Feb. 4, 2005) ("*TRRO*").

¹⁴ I discuss issues involving the implementation of §271 in the final section of my testimony.

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Table 2:

			15

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As Table 2 shows, virtually all of the residential lines claimed by SBC are actually served by only six (6) carriers. Although SBC points to 19 carriers in the market, the other 13 carriers that it named collectively serve 1% of the market. Of these six carriers, one carrier (discussed further below) competes exclusively using UNE-L, while *** of the remaining residential lines are on UNE-P. Moreover, the two largest UNE-P based entrants have announced they are exiting the market. Given the uncertainty surrounding the continued availability of UNE-P, I do not believe that the Commission can include within its analysis lines served by UNE-P carriers as evidence of residential competition.

¹⁵ I inserted a random sample of Wisconsin exchange numbers in Rate Groups A and B requesting service from the Talk America website and the message was returned that service in those areas is not available. Although TALK has not announced its future plans for Wisconsin, its network expansion plans to replace UNE-P only reference its lines and operations in Michigan. *See* Talk Announces 4th Quarter and Full Year 2004 Results, March 1, 2005. The company had earlier announced plans to scale back customer acquisition activities to states with networking potential. *See* Talk America to Refocus Marketing Efforts; Revenues and Net Income to be Within Guidance for Q3 and 2004; Billed Bundled Lines Guidance Lowered for Q3 and 2004, September 1 2004. Consequently, one cannot reasonably rely upon TALK to continue competing in Wisconsin.

1 **Q. Can the Commission confidently rely on continuing competition from**
2 **McLeodUSA?**

3
4 A. No, I do not believe that it can. McLeodUSA has announced that it is actively
5 pursuing a strategic partner or sale of the company in direct response to the FCC's
6 curtailment of unbundling rules and the additional concentration of its competitors
7 through mergers.¹⁶ Previously, McLeodUSA had announced a program to
8 eliminate unprofitable customers, shedding over 28,000 customers that had been
9 valued at \$9.5 million in revenue (an average of over \$113 per customer per
10 month).¹⁷ Given that the company is for sale (which frequently indicates a change
11 in strategic direction), combined with its program to eliminate "unprofitable"
12 customers whose average revenue far exceeds average residential levels, indicates
13 that the company should not be relied upon as offering effective competition in
14 the residential market. I also note that, consistent with these concerns,

15 ***

16 ***.¹⁸

17
18 **Q. Should the Commission place any weight on the level of residential**
19 **competition occurring via resale?**
20

¹⁶ McLeodUSA Reports Fourth Quarter and Total 2004 Results, March 16, 2005.

¹⁷ McLeodUSA Reports Fourth Quarter and Total 2003 Results, February 18, 2004.

¹⁸ Source: SBC Response to 3-CUB-6, and JRL-7.

1 §196.195(2)(a)(5) that the Commission evaluate trends and conditions that would
2 affect future performance.

3
4 **Q. Do you believe it would be reasonable for the Commission to deregulate SBC**
5 **based on the competitive activities of a single firm?**

6
7 A. No. To begin, when there is competition from but a single firm, it is more likely
8 evidence of some unique advantage than low entry barriers. In the case of TDS
9 Metrocom, that advantage stems from its affiliation with a nearby incumbent local
10 exchange carrier.²⁰ As TDS explained in its 2002 annual shareholder meeting:

11
12 ... TDS Metrocom aims for high penetration in carefully selected
13 markets, mainly suburban and urban-fringe markets, targeting
14 small to mid-sized businesses and “communications-intensive”
15 residential customers. By carefully choosing its areas of
16 operations near TDS Telecom’s existing operations, TDS
17 Metrocom is able to leverage TDS Telecom’s management and
18 process infrastructures.²¹
19

20 Because of its relationship with an incumbent local exchange carrier, the
21 evidentiary value of TDS Metrocom is limited. The operations of this carrier
22 reflect a unique advantage that masks substantial barriers that prevent effective
23 competition from developing.

24

²⁰ The Commission is required to consider the significance of any affiliation that may affect competition. §196.195(2)(a)(5).

²¹ TDS 2002 Annual Report, page 4.

1 In addition, the Commission should not reach effective competition findings
2 based on the operations of a one carrier because competitive conditions would
3 then be decided by the management of a single firm. TDS may or may not
4 continue to compete in residential markets in the future – its 2004 annual report
5 references concerns with FCC unbundling decisions, as well as its vulnerability to
6 UNE rate increases. As a consequence, TDS wrote down the value of its physical
7 assets and goodwill associated with its Metrocom affiliate.²²

8
9 A finding of effective competition should require that the Commission observe
10 widespread competition consistent with low entry barriers.²³ If a market is
11 characterized by multiple providers and low barriers, then the level of competition
12 is effectively insulated from the management decisions of a single firm. This is
13 not the case in Wisconsin today, where the residential competition (post UNE-P)
14 is concentrated in a single firm, TDS Metrocom.

15
16 **Q. Is the level of competition in Rate Groups A and B, in the absence of UNE-P,**
17 **any greater than the current level of competition in Rate Group C (for which**
18 **SBC has not sought the suspension of price regulation)?**

²² TDS 2004 Annual Report, page 39.

²³ There are obviously substantial barriers to entry in local telecommunications markets – particularly residential markets – that even the market opening provisions of the 1996 Act have failed to overcome. Among other barriers are the significant costs to develop networks capable of supplying the analog-based communications needs of most residential customers, overcoming the incumbent's name recognition, its economies of scale and its other operational advantages (such as preexisting rights-of-way) stemming from its legacy as a governmentally-protected monopolist.

1

2 A. No. Accepting as valid all of SBC's claims, the competitive share of CLECs in
3 Rate Group C is *** ***.²⁴ SBC has not asked that price regulation be
4 suspended in this rate group, presumably because it falls short of the higher levels
5 of competition in Rate Group A (*** ***) and Rate Group B (*** ***)
6 Yet, without UNE-P, the level of competition in Rate Group A would drop to
7 *** ***, and the competition in Rate Group B would fall to *** *** --
8 both below the level of competition in Rate Group C today.

9

10 **Q. To this point you have "accepted as valid" SBC's data, while challenging how**
11 **the data should be interpreted. Is there reason to believe that SBC's data is**
12 **also inflated?**

13

14 A. Yes. Two of the carriers serving the residential market using their own switches
15 (TDS Metrocom and McLeodUSA) lease loops from SBC. Although SBC
16 directly tracks the number of loops that it leases to TDS Metrocom and
17 McLeodUSA, it has nevertheless extracted data from the E911 database to
18 estimate the number of residential lines served by these carriers. To explain the
19 difference between the number of lines in the E911 database and the number of
20 loops that SBC leases these companies, SBC assumes that these companies serve
21 residential customers over their own loops (or loops acquired from third parties).²⁵

²⁴ Source: SBC Response to 1-CUB-10.

²⁵ Source: SBC Response to 2-CUB-6.

1

2 **Q. Is SBC’s assumption that these carriers serve residential customers over**
3 **their own loops significant to its competitive estimates?**

4

5 A. Yes. This assumption has a very significant impact on the number of lines
6 claimed by SBC for carriers using their own switches. Table 3 details the line-
7 increase resulting from this assumption for the two largest switch-based CLECs.²⁶

8

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9

Table 3: ²⁷

10

11

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12

13 **Q. Do you have reason to believe that SBC’s assumption that the difference**
14 **between its UNE-L billing records and E911 database entries are invalid?**

15

16 A. Yes. Both TDS Metrocom and McLeodUSA were asked in discovery whether
17 they served any residential customers using their own loop facilities and each

²⁶ These two carriers explain *** *** of the lines that SBC assumes exist (i.e., the number of lines, based on the E911 database, in excess of those attributable to residential loops leased from SBC).

²⁷ Source: JPL-7

1 responded that they did not.²⁸ Thus, SBC's assumption that such loop facilities
2 exist is false.

3
4 **Q. Will the elimination of UNE-P also harm UNE-L?**

5
6 A. Yes. A fundamental problem with *any* UNE strategy is its reliance upon SBC as a
7 retail carrier reluctantly offering wholesale service under legal mandate. This
8 problem is marginally reduced when a carrier leases only the loop from SBC,
9 instead of the loop and switch.²⁹ Significantly, the costs to police and enforce
10 UNE-rights – i.e., the CLEC effort needed to support cost analyses, monitor
11 performance plans and monitor SBC actions – has largely been absorbed by
12 AT&T and MCI.

13
14 The elimination of UNE-P reduces dramatically the number of UNE-lines capable
15 of funding UNE-enforcement and protection efforts. On a statewide basis, 70%
16 of all UNE activity is associated with UNE-P. Moreover, the realignment of
17 AT&T and MCI's regulatory resources from their prior devotion to keeping
18 markets *open* to their future role *foreclosing* competitive opportunity (by being
19 absorbed into RBOCs) places the future stability of the entire UNE regime in
20 question.

²⁸ Sources: TDS Metrocom Response to 1-CUB-1 and 1-CUB-2, and McLeodUSA
Response to 1-CUB-1 and 1-CUB-2.

²⁹ Nearly 75% of the average UNE-P cost is caused by the loop component that is also
leased in the UNE-L configuration. Source: Telecom Regulatory Note: Updated UNE Prices,
Regulatory Source Associates, August 16 2004.

1

2 **Q. SBC claims that UNE-P’s elimination will not harm competition because**
3 **CLECs can shift to other competitive options and SBC offers “competitive,**
4 **market-based rates.”³⁰ Do you agree?**

5

6 **A. No.** First, the Commission can already expect a reduction in competitive activity
7 of nearly *** *** as a result of the AT&T and MCI’s abandoning the
8 market.³¹ Perhaps SBC could have persuaded AT&T to remain a competitor
9 through its offer of “competitive” rates, but the facts show that AT&T would
10 rather join SBC than fight it.

11

12 More fundamentally, however, is the fact that SBC has shown quite clearly that it
13 has no intention of accommodating widespread, profit-constraining, competition
14 over its own facilities. Realistically, absent a regulatory requirement, why would
15 SBC voluntarily lease network facilities to rivals at prices that would constrain its
16 retail rates and profits? Such lease rates are in the public interest, but they
17 certainly do not further SBC’s private interests.

18

19 Consider the following “proposal” from SBC. Although SBC is no longer
20 required to offer local switching (and, therefore, UNE-P) under §251 of the
21 federal Telecommunications Act (which requires TELRIC rates), it remains

³⁰ Loehman Direct, page 20

³¹ Source: JRL-7.

1 obligated to offer its equivalent under §271 of the Act (which permitted it to offer
2 long distance services in Wisconsin. Although the FCC has determined that
3 Section 271 elements are subject to a potentially more liberal pricing standard
4 than the standard that applies to elements offered under Section 251 of the Act,
5 SBC's rates for local switching must remain just, reasonable, nondiscriminatory
6 and provide meaningful access:
7

8 Thus, the pricing of checklist network elements that do not satisfy
9 the unbundling standards in section 251(d)(2) are reviewed
10 utilizing the basic just, reasonable, and nondiscriminatory rate
11 standard of sections 201 and 202 that is fundamental to common
12 carrier regulation that has historically been applied under most
13 federal and state statutes, including (for interstate services) the
14 Communications Act. Application of the just and reasonable and
15 nondiscriminatory pricing standard of sections 201 and 202
16 advances Congress's intent that Bell companies provide
17 meaningful access to network elements.³²
18

19 **Q. Has SBC proposed a “§271 rate” for local switching at rates that are “just**
20 **and reasonable,” much less rates that provide competitors meaningful access**
21 **to compete?**
22

23 A. No. On March 11 2005, SBC “posted” what it claims to be its §271 local
24 switching offering.³³ The terms and conditions of SBC's so-called “§271
25 offering” are unambiguously unreasonable and are designed to assure that it has

³² TRO ¶ 663 (footnotes omitted).

³³ SBC Accessible Notice CLECALL05-040, March 11, 2005.

no commercial use.³⁴ Most egregious is the *price* that SBC proposes -- the average “§271 rate” proposed by SBC is \$42.00 per month, and this charge does not even include the additional costs of the loop and the collocation facilities that SBC would impose on CLECs in order to have a working line.

In the table below, I compare the “§271 rate” for local switching proposed by SBC to three cost-standards. The first is the cost-based TELRIC rate adopted by the Wisconsin Commission; the second is the TERLIC-rate adopted by the FCC in the Virginia Arbitration (which is the same as that set by the WPSC);³⁵ and, the third is an estimate of SBC’s embedded cost of switching in Wisconsin.

Table 4: Comparing SBC’s Proposed Local Switching Rate to Various Measures of Just and Reasonable

Just and Reasonable Cost Standard	Cost	§271 Rate	% Increase
TELRIC-based Rate Set (Wisconsin PSC)	\$2.83	\$42.00	1,384%
TELRIC-based Rate Set by (FCC)	\$2.83	\$42.00	1,384%
Est. Embedded Cost of Switching ³⁶	\$2.11	\$42.00	1,891%

³⁴ In addition to the rate levels proposed by SBC, other obvious failings of the offering include: SBC will not commingle §271 switching with local loops (provided pursuant to §251); §271 switching may only be accessed via unnecessary collocation arrangements; and SBC’s §271 switching will not route intraLATA calls in the same manner that SBC routes such traffic for itself.

³⁵ Memorandum Opinion and Order, CC Dockets 00-218 and 00-251. Switching costs should not vary significantly between RBOCs because switches are acquired under nationally-negotiated contracts with a limited number of manufacturers. In other words, the cost to Verizon to purchase a switch from Nortel or Lucent in Virginia should differ little from the cost that SBC would incur to purchase the same switch from these manufacturers for installation in Wisconsin. As such, the TELRIC-cost of local switching established by the FCC is a useful factor when evaluating the reasonableness of local switching prices nationally.

³⁶ The “Embedded Cost of Switching” for SBC is calculated by adding SBC’s reported central office switching expense per switched access line (2004 ARMIS 43-03) to an estimate of SBC’s reported depreciation costs for 2004 that can be attributed to its switching investment

1
2 To emphasize, under the terms of SBC's "\$271 offer," the average charge of
3 \$42.00 per month is for the local switching element *only* – to this, a CLEC would
4 still have to incur collocation costs, lease a loop and pay for transport in order to
5 offer a complete retail service. In contrast, SBC's average residential revenue per
6 primary residential line in Wisconsin is *** *** per month.³⁷ Obviously,
7 the rates proposed by SBC are not intended to be just and reasonable, nor would
8 they offer competitors a meaningful opportunity to compete.
9

10 **Q. SBC argues that the Commission should count as a competitor every**
11 **provider with a residential line, no matter how few, arguing that such**
12 **provisioning shows a "capability to serve."³⁸ Do you agree?**
13

14 A. No. Such activity -- which even SBC acknowledges may be "incidental" to a
15 business-oriented plan³⁹ -- is not evidence of a low entry barrier; it merely
16 indicates that some business accounts can be made more attractive by offering
17 limited service to management or employees. This is not evidence of a residential
18 offering that could reasonably be expected to constrain SBC's pricing behavior to
19 residential customers generally. More fundamentally, ancillary services offered
20 as part of a business service say nothing about whether a carrier has an *economic*

(2004 ARMIS). This latter value is estimated by applying a 15-year depreciation rate to the average annual change in total plant in service (switching) for 1990-2004.

³⁷ Source: SBC Response to PSC 2-25(a).

³⁸ Loehman Direct, page 10.

³⁹ Loehman Direct, page 10.

1 capability to serve residential customers – indeed, if anything, such activity
2 proves the opposite because it indicates that even a carrier with an established
3 network footprint and *comparatively* (to other potential entrants) lower
4 incremental costs to serve the residential market still faces barriers that prevent its
5 entry.⁴⁰

6
7 **Q. Please summarize your testimony with respect to the status of traditional**
8 **residential wireline competition in Rate Groups A and B in Wisconsin.**

9
10 A. With the exception of the operations of a single provider, most of the residential
11 competition in Rate Groups A and B (i.e., 90%) is dependent upon an entry
12 strategy (UNE-P) that has been made a nullity due to SBC's persistent efforts to
13 eliminate its commercial application. Because of these actions, two of the largest
14 CLECs are in the process of exiting the market and being acquired by the nation's
15 largest RBOCs, all so that local entry is no longer necessary to their survival.

16
17 Although the mergers of AT&T and MCI into SBC and Verizon have not yet been
18 approved (and in the case of MCI/Verizon, not yet formalized), it is the economic
19 circumstances that caused these mergers to be proposed that is most relevant to
20 my discussion here (and not the mergers themselves). Each merger application

⁴⁰ For instance, business services served by switch-based CLECs are frequently provided using high-capacity loop facilities that support integrated voice and data services, whereas conventional residential services require analog connections that are far more costly to interconnect to CLEC network facilities.

1 filed with the FCC explains that AT&T and MCI exited the consumer market
2 because of FCC unbundling rules regarding UNE-P – a fact of evidentiary
3 importance in judging whether entry barriers remain in the local market.⁴¹
4

5 The instability in the UNE-platform can already been seen in the residential
6 market. Table 5 (below) compares the claimed levels of residential competition
7 in SBC's core filing (data as of September 2004) to equivalent data three months
8 later (data as of December 2004). As this data shows, UNE-P based competition
9 is already declining at a rate that cannot be offset by growth in other strategies.

10 ***CONFIDENTIAL***
11

Table 5: ⁴²

12 ***CONFIDENTIAL***
13
14

15 A second trend seen in the data above, however, is the emergence of cable-based
16 providers of phone service (as shown in the growth of lines served by CLEC
17 loops). Although I am not accepting the *absolute* accuracy of SBC's claims,⁴³ the

⁴¹ See MCI Declaration of Wayne Huyard, Appliation For Transfer of Control, WC Docket 05-075, March 11 2005 and AT&T Declaration of John Pumbo, Description of Transaction, Public Interest Showing and Related Documentation, February 21 2005.

⁴² Source: JRL-7 (Sept. 2004), and SBC Response to 1-CUB-10 (Dec. 2004).

⁴³ My testimony earlier explained that SBC inflated the number of lines served over CLEC facilities in September 2004 through false assumptions concerning TDS Metrocom and

1 *relative* data does suggest growing loop-based competition (which is consistent
2 with cable entry). Because of the unique issues presented by the presence of these
3 carriers, I discuss their importance separately below.

4
5 **(b) The New Wireline Competitors – Cable Based Providers**
6

7 **Q. Is there evidence that cable-based competition is beginning to emerge in**
8 **Wisconsin?**

9
10 A. Yes. However, unlike the UNE-based forms of entry discussed above, which
11 could (as UNE-P did) reduce entry barriers broadly in the market with products
12 that were technologically equivalent to BLS, cable-based telephony raises other
13 issues. Specifically:

14
15 * Some cable-architectures introduce issues concerning
16 whether the services are comparable to traditional
17 telephony;⁴⁴
18

McLeodUSA. I would expect that that SBC's claims regarding the number of CLEC loops in December 2004 are similarly inflated.

⁴⁴ I note that this issue goes to the *technical* capability of the service, not whether it is priced and packaged as a substitute for stand-alone basic local exchange service. As I indicated at the outset of my testimony, I believe that the Commission should evaluate whether there are competitive alternatives to stand-alone BLS before deregulating that service. However, before turning to that issue, I first address competitive conditions in the residential market more generally, without limiting the analysis to stand-alone products. Thus, the issue I address here concerns the technical comparability of the cable-telephony products in Wisconsin, not whether they are economically equivalent or a substitute.

1 * Cable-entry is limited by the cable-footprint and may leave
2 substantial areas without competitive choice, and
3

4 * Even in those areas where the cable-footprint overlaps
5 SBC's service territory, cable-entry will not assure
6 effective competition because entry by other firms may not
7 be possible with the result being a duopoly.
8

9 **Q. Why do you say that the services offered by the cable providers may raise**
10 **issues of technical equivalency?**
11

12 A. It is important to understand that cable providers can deploy different
13 architectures that result in different service characteristics. For instance, Time
14 Warner's⁴⁵ service is capable of supporting only one line and the service is
15 dependent upon the household electric supply to operate. Consequently, during a
16 power outage, the customer would lose its phone service (and ability to contact
17 emergency services).⁴⁶
18

19 In contrast, Charter's network includes battery backup that would provide
20 telephone service to customers for eight to ten hours (but would also fail with a

⁴⁵ I note SBC's testimony concerning "Time Warner" discusses both Time Warner Telecom and Time Warner Cable. Although both carry the name "Time Warner", these entities are not the same. Time Warner spun off Time Warner Telecom in 1998 and the company uses the name Time Warner under a licensing agreement. Time Warner Telecom does not compete in the residential market.

⁴⁶ Another potential failing concerns the ability to support fax service. Time Warner acknowledges in other markets that its Digital Phone Service does not support fax service. Time Warner's Wisconsin web information is silent on this point and emails to Time Warner's customer support asking about the effect on fax services were not answered.

1 more extended outage).⁴⁷ In addition, Charter is able to support two lines,
2 instead of one.
3

4 **Q. Do you believe that the Commission need determine whether the services**
5 **offered by Time Warner and Charter are the “same, equivalent or**
6 **substitute” services to BLS?**
7

8 A. No, I do not believe that the Commission need reach this issue at this time. There
9 are other factors that I believe support the Commission rejecting this application
10 even with the emerging presence of these cable-competitors. These factors
11 include the fact that the competitive overlap between the cable footprint and SBC
12 footprint does not support competition across the market, the fact that a single-
13 provider is not sufficient to achieve effective competition, and the fact (discussed
14 later) that the pricing of these services is not structured as an alternative to stand-
15 alone BLS.⁴⁸
16

17 **Q. Have you attempted to estimate the degree of overlap between the cable-**
18 **footprint and SBC’s territory in these markets?**
19

⁴⁷ <http://support2.charter.com/support/telephone/contentredirect.asp>

⁴⁸ CUB does not have the resources to fully evaluate other technical parameters, such as reliability, interconnection to E911 services, or quality.

1 A. Yes. To estimate the potential geographic overlap between the cable-based
2 providers (Time Warner and Charter) in Wisconsin and SBC, I applied a
3 methodology that is virtually assured to overestimate the degree of overlap
4 between these carriers and SBC. This methodology started with the E911
5 database and assumed that if Time Warner (Sprint)⁴⁹ or Charter had a *single*
6 listing in a wire center, then they were capable of serving *every* customer in that
7 wire center.
8
9 Importantly, this methodology can be expected to significantly overstate the
10 geographic overlap between the cable carriers and SBC because cable-carriers do
11 not reach customers using loop facilities leased from SBC. As a result, when a
12 cable-carrier serves one customer in a wire center that does not imply that they
13 can actually serve all other customers, unless coincidentally their network passes
14 each of the homes in that wire center.⁵⁰ Because the methodology inherently
15 overstates the degree of overlap, the methodology cannot be used *prove* that there
16 is significant overlap, but it can demonstrate that the overlap is *insufficient* to
17 protect customers.

⁴⁹ Like Mr. Loehman, I am assuming that Sprint Communications is providing E911 management services to Time Warner Cable. See “Sprint, Time Warner Cable Sign Agreement that Helps Enable Time Warner Cable to Offer Telecom Services,” Sprint Press Statement, December 8 2003. Consequently, all E911 listings reported as Sprint have been attributed in Time Warner. This assumption could potentially overstate Time Warner’s E911 listings and, as a result, its geographic coverage.

⁵⁰ I also note that the methodology would overstate lines to the extent that the E911 database itself may produce inconsistent results (see discussion regarding McLeodUSA and TDS Metrocom above).

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Table 6:

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As shown in Table 6 (above), even applying a methodology that overstates cable-coverage, significant areas of Rate Groups A and B would be without competitive choice from cable-based entry. (In no instance did both Charter and Time Warner serve customers in the same wire center). Thus, even the rather dubious protection of a cable-Telco duopoly would fail to protect *** or more of the customers in these areas (assuming that the services are equivalent, particularly with regards stand-alone BLS).⁵¹

(c) Intermodal Alternatives

Q. In addition to traditional forms of competition, SBC also claims that so-called “intermodal alternatives” – i.e., Voice over Internet Protocol and wireless service – should be treated as equivalent to BLS.⁵² Do you agree?

⁵¹ SBC did not provide data regarding the overlap between the cable-based providers and their service territories in Rate Groups A and B. In fact, in response to 3-CUB-10 asking SBC to identify the degree of overlap, SBC objected that it would be “patently unreasonable to expect SBC Wisconsin to possess all of the data necessary to completely answer” the request.

⁵² See, for instance, Shooshan Direct.

1

2 A. No. For a wide range of reasons, I do not believe it is appropriate to consider
3 wireless service or VoIP as substitutes to basic local exchange service. To begin,
4 I note that SBC appears to take very different positions on this question itself,
5 depending upon the circumstances.

6

7 For instance, as part of the FCC's review of the acquisition of AT&T Wireless by
8 SBC's affiliate Cingular Wireless, SBC took the position that wireless service was
9 not in the same product market as wireline service:

10

11 The relevant product market for the analysis of this transaction
12 excludes wireline services. Although there is some competition
13 between wireless and wireline services, it is not currently sufficient
14 to conclude that a wireless-only product market is too small for
15 antitrust analysis of this transaction.... At the present time,
16 wireline service is sufficiently differentiated from wireless service
17 to exclude wireline from the relevant product market.⁵³
18

19 This view is consistent with the view articulated by SBC's Chairman Edward
20 Whitacre:

21

22 It's not going to displace the wire-line network. It's certainly
23 going to be a big product, but it's never going to be the substitute.
24 Reliability is one reason.⁵⁴
25

⁵³ Sworn Affidavit of Richard J. Gilbert before the Federal Communications Commission, WT Docket No. 04-70, filed March 18, 2004 (emphasis added).

⁵⁴ *A Wireless World*, Business Week, October 27, 2003, page 111.

1 I also note that the FCC treats wireless service as a separate market, recently
2 concluding that UNEs cannot be used to provide wireless service:

3
4 The local services market does not share the competitive
5 conditions, observed in the wireless market and long distance
6 market, that would support a parallel finding that the costs of
7 unbundling outweigh the benefits.⁵⁵
8

9 Thus, in a single finding, the FCC both affirmed that the wireless and local
10 services are separate markets, and that the local services market is not as
11 competitive as the wireless market.

12
13 **Q. Are you aware of any independent studies that have attempted to quantify**
14 **the level of wireless substitution?**

15
16 **A.** Yes. The Center for Disease Control and Prevention has no vested interest in
17 telecommunications market structure, but it is concerned that random telephone
18 surveys accurately sample health statistics in the United States. As such, a series
19 of questions was recently added to the National Health Interview Survey (NHIS)
20 to measure wireless substitution.⁵⁶ This survey concluded that only 3% of the
21 population relies on a wireless phone, with only 2.5% of the adult population
22 (over 25) doing so. Seniors are the most unlikely to substitute wireless service,

⁵⁵ *Triennial Review Remand Order*, Federal Communications Commission WC Docket 04-313, February 4, 2005, (“*TRRO*”), ¶ 38.

⁵⁶ Joint Paper, *The Prevalence of Wireless Substitution*, and *The Impact of Wireless Substitution on Random-Digit-Dialed Health Surveys*, S. Blumberg, J. Luke and M. Cynamon, Centers for Disease Control and Prevention, National Center for Health Statistics, May 2004.

1 with only 0.5% of that population reporting they rely only on a wireless phone,
2 while 98% of the senior population relies exclusively on a wireline phone.

3
4 In addition, the US Census Bureau periodically tracks telephone usage patterns as
5 part of its Current Population Survey.⁵⁷ Although the share of subscribers that
6 rely on wireless service by the Census Bureau is somewhat higher (5.7%) than the
7 NHIS study, the *pattern* of wireless reliance mirrors that of the NHIS study.
8 Wireless reliance is most heavily concentrated among the young population, and
9 declines significantly for that portion of the population above 24 years of age.

10
Table 7: Summary of Independent Surveys on Wireless Reliance

Survey Sponsor	Percentage of Population with:			
	Wireless Only	Wireline Only	Both	None
Center for Health Statistics	3.0%	50.9%	43.0%	2.1%
US Census Bureau	5.7%	37.9%	51.6%	4.7%

11 These studies highlight that the wireless-only phone subscriber is only slightly
12 more prevalent than the household with no phone at all. While wireless service is
13 certainly popular – and there is no question that some *usage* has shifted from the
14 wireline network to the wireless network⁵⁸ -- the fact remains that the actual
15 replacement of wireline service with wireless service remains rare.
16

⁵⁷ *Household Telephone Service and Usage Patterns in the U.S. in 2004*, Clyde Tucker, Bureau of Labor Statistics, with J. Michael Brick, Westat, Brian Meekins, Bureau of Labor Statistics, and David Morganstein, Westat.

⁵⁸ To the extent that usage has shifted to wireless phones due to the prevalence of flat-rate pricing for wireless service (i.e., no toll charges), that advantage is easily addressed by local carriers offering flat-rate wireline plans (which SBC-MI finally introduced in response to wireline competition).

1

2 **Q. Should the Commission consider VoIP as a substitute for wireline service?**

3

4 A. No. To begin, I note that VoIP service are only just now entering the market and
5 it is far too early to conclude that they are inevitable substitutes for traditional
6 phone services.⁵⁹ The FCC estimates that there are currently (January 2005) 722
7 thousand VoIP lines in service, which would imply a penetration rate of 0.4%.⁶⁰

8

9 Moreover, there are very important structural barriers that seriously limit the
10 extent to which VoIP is likely to develop, at least in the near term. The VoIP-
11 addressable market is limited to customers with broadband connections. Indeed,
12 given SBC's refusal to offer DSL without customer's choosing SBC for voice
13 service,⁶¹ it is reasonable to exclude DSL connections from the VoIP addressable
14 market. To the extent that a customer must subscribe to voice service to obtain
15 DSL, VoIP is (as the FCC has concluded) a "supplement to, rather than a
16 substitute for, traditional local exchange service."⁶²

⁵⁹ I use the term VoIP here to describe a service where the customer is clearly marketed and sold a product that requires interconnection of the customer's phone to a packet-converter/router as part of the application. I do not include within this definition telephone services in which an IP-based transmission link is used as part of the internal network architecture of the provider. In configurations where VoIP is merely part of the internal architecture of the provider (for instance, Charter offers service in this manner), the lines served by such companies have already been estimated through the traditional means (i.e., UNE-L counts or E911 listings) discussed above.

⁶⁰ See http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-256206A2.pdf and http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom1204.pdf.

⁶¹ Source: SBC response to 2-CUB-11.

⁶² *TRRO*, footnote 118.

A recent study conducted by the NTIA demonstrates that the pattern of broadband deployment among residential customers is insufficient for VoIP to replace UNE-P as the principal vehicle for mass market competition.⁶³ The NTIA analyzed national broadband penetration statistics collected by the Census Bureau for households with different levels of household income.⁶⁴ The relative penetration rates of broadband are summarized below, showing that potential VoIP customers are effectively limited to higher income households.

Table 8: Contrasting the Addressable Markets for VoIP and UNE-P

Entry Strategy	Annual Household Income			
	Under \$25K	\$25k to \$50K	\$50K to \$75K	\$75K +
UNE-P Addressable Market ⁶⁵	95.9%	93.0%	89.5%	83.4%
VoIP Addressable Market	5.9%	9.7%	15.6%	24.7%
VoIP Addressable (with DSL)	9.9%	16.7%	26.1%	41.3%

As I noted earlier, because DSL service is already packaged with local phone service, the VoIP-addressable market is better estimated by excluding DSL penetration. However, even if DSL households are included in the analysis, the potential addressable market for VoIP is roughly ½ that could have been served by UNE-P, even in the most wealthy households.

⁶³ See *A Survey of Small Business' Telecommunications Use and Spending*, SBA Office of Advocacy, March 2004. *A Nation Online: Entering the Broadband Age*, NTIA, Sept. 2004, Appendix Tables 2, 4.

⁶⁴ To place the table in perspective, the national median household income is \$43.5K per year and is \$46.8K in Wisconsin. Source: www.census.gov/hhes/income/income03.html (US Census Bureau).

⁶⁵ Excludes that portion of the market served by DSL because UNE-P is not available for customers obtaining DSL service from the incumbent (or, more precisely, the customer would have to sacrifice its DSL service in order to obtain competitive voice service from a carrier provisioning service using UNE-P).

1

2 **Q. Does the FCC consider VoIP as a substitute for traditional local exchange**
3 **service?**

4

5 A. No. In its *TRRO* analysis, the FCC specifically rejected claims that VoIP should
6 be seen as a substitute for wireline telephone service:

7

8 Although we recognize that limited intermodal competition exists
9 due to VoIP offerings, we do not believe that it makes sense at this
10 time to view VoIP as a substitute for wireline telephony.⁶⁶
11

12 Moreover, SBC itself does not believe that VoIP is a price-constraining
13 alternative to its services, at least in its filings explaining why its acquisition of
14 AT&T would not harm competition.

15

16 In the mass market, AT&T's independent, irreversible decision to
17 stop pursuing such [mass market] customers for either its local or
18 long distance wireline telephony means it is no longer a substantial
19 competitor in that market, and the elimination of AT&T as an
20 independent corporate entity could not harm mass market
21 competition.

22

23 ***

24

25 ...AT&T made a carefully considered unilateral decision to
26 cease actively marketing traditional local and long distance
27 services to residential and small business customers.... In
28 furtherance of its decision, AT&T immediately began to take steps
29 to reduce and eventually eliminate an active price constraining role

⁶⁶ *TRRO*, footnote 118.

1 in the provision of services to residential and small business
2 customers.⁶⁷
3

4 Obviously, if AT&T's VoIP offering (CallVantagesm) was as significant as SBC's
5 witnesses imply here, then SBC's characterization of the competitive
6 consequences of its acquisition of AT&T would be less than forthright.⁶⁸
7

8 **Q. Has SBC provided an estimate of the level of VoIP and wireless share loss**
9 **that it claims it faces?**
10

11 A. Yes. SBC offers an analysis that claims to measure the total level of intermodal
12 share loss in Wisconsin.⁶⁹ In effect, SBC has conducted a "missing lines"
13 analysis that it then attributes to intermodal competition. The basic form of its
14 analysis is:

$$\begin{array}{r} \text{Estimate of \# of Households in Wisconsin in Rate Groups A and B} \\ \times (\text{Estimate of \% of Households with Phone Service}) \\ \hline \text{Estimate of Households with Phone Service} \\ \quad - \text{Lines Served by} \\ \quad \quad \text{SBC} \\ \hline \text{Lines Assumed Served by CLECs and Intermodal} \\ \quad - \text{Estimated Lines Served by Conventional CLEC} \\ \quad \quad \text{Methods} \\ \hline \text{Residual Assumed to be Intermodal Lines} \end{array}$$

⁶⁷ *Description of the Transaction, Public Interest Showing, and Related Demonstrations* ("Public Interest Statement") filed with the Federal Communications Commission, February 21 2005, page 51, pages v and 51 respectively. Emphasis added.

⁶⁸ I fully expect that SBC will claim that its statements are fully consistent, pointing out that the quote refers to "wireline telephony." However, it is clear that SBC is describing AT&T's irreversible decision to abandon an entire customer segment (the mass market) and it is SBC who is claiming here that VoIP is a substitute for wireline telephony in that market.

⁶⁹ See Exhibits AET-6 and JRL-4.

1

2 **Q. What is wrong with this methodology?**

3

4 A. In theory, if each of the variables were correct, then perhaps the formula would
5 provide a useful estimate. The problem concerns the errors introduced with each
6 estimate and the calculation contains no less than three separate estimates. SBC
7 estimates that there are nearly *** *** residual/intermodal lines (September
8 2004) for an “intermodal share” of approximately *** ***.

9

10 **Q. Have you compared SBC’s intermodal share estimate to other data to**
11 **determine its validity?**

12

13 A. Yes. As I noted earlier, the FCC estimates that there are 722,000 VoIP lines
14 nationwide. If distributed in proportion to broadband lines, this would indicate
15 that there are approximately 12,500 VoIP lines in Wisconsin (for a local share of
16 1.3%).⁷⁰ Combined with the wireless share estimates developed by the Census
17 Bureau (5.7%) and the Center for Health Statistics (3%) suggests that a range of
18 intermodal share of between 4.3% to 7.0% (with an average intermodal share of
19 6.0%), most of which reflects wireless share.

⁷⁰ The number of VoIP lines in Wisconsin is assumed proportional to the number of broadband lines in the state. Source: High Speed Services for Internet Access: Status as of June 30 2004, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, December 22, 2004. Because of the higher-than-average broadband penetration in Wisconsin, the penetration of VoIP is also assumed higher in Wisconsin.

Q. Do you believe that this level of intermodal share justifies a finding that wireless service is a “same, equivalent or substitutable” service to BLS?

A. No. There is not question that wireless service is popular and that usage has grown at the expense of usage on the wireline network. This does not mean, however, that wireless service is a sufficient substitute to effectively police SBC’s pricing behavior for BLS – particularly the stand-alone BLS that is at issue here.

Moreover, when one looks inside the wireless estimates from both the Census Bureau and Center for Health Statistics, it is clear that much of the very modest share gain that has occurred is occurring among very young households and not the population at large.

Table 9: Wireless Share by Age Group

Center for Health Statistics	Age Groupings			
	18-24	25-44	45-64	65+
	6.7%	4.1%	1.6%	0.5%
U.S. Census Bureau	Age Groupings			
	15-24	25-34	34-54	55+
	18.3%	9.6%	5.0%	2.5%

Again, the point is not whether there are some consumers relying exclusively on wireless phones. The relevant question here is whether the degree of substitution is so significant that an increase in price of BLS would cause enough customers to shift to wireless services that SBC’s pricing behavior is constrained. I am

1 unaware of a single regulatory agency that has reviewed this issue and concluded
2 that wireless service is an effective substitute for basic local service at this time.

3
4 **Q. SBC has also sponsored a study that claims that 28% of the wireless users do**
5 **not have “traditional phone service” in their homes.⁷¹ Should this survey be**
6 **given any evidentiary weight?**

7
8 A. No. Although SBC claims that it is unable to correlate the survey with the
9 number of households, unless it happened to survey consumers from the same
10 household – a remarkable coincidence with a survey of approximately 600
11 participants in a population of nearly one million households⁷² – the Commission
12 should assume that each wireless subscriber answered for a distinct household.
13 The implied claim that 28% of the residential market no longer subscribes to BLS
14 is so dramatically out-of-line with SBC’s own estimate (roughly *** *** for
15 all intermodal competitors), the Census Bureau Survey (5.7%) and the Center for
16 Health Statistics (3%) that I believed it should be disregarded.

17
18 One possible cause of the outlier results reported by SBC’s survey is confusion
19 over the phrase “traditional phone service.” This term could mean quite different
20 things to different consumers – indeed, it is entirely possible that someone
21 receiving local phone service from a competitor would consider the service non-

⁷¹ Shooshan Direct, page 4.

⁷² AET-6.

1 traditional given the monopoly structure has been in-place for the *lifetimes* of
2 most anyone surveyed.⁷³ For instance, there is the remarkable coincidence that
3 the percentage of respondents that answered they had non-traditional phone
4 service in their home (28%) closely matches the estimate (without SBC's
5 intermodal claims) of CLEC share in the residential market (26.3%). In fact,
6 accepting SBC's wireline data as valid, eliminating the potential inflating effect of
7 the E911 database, then adding the wireless substitution estimate from the NHIS
8 and the VoIP estimate from the FCC, the resulting CLEC market share is 28%.

9
10 **Q. Does SBC market wireless service as though it is a substitute for BLS?**

11
12 A. No. SBC markets wireless services as part of a bundle alongside their local
13 exchange service.⁷⁴ Such bundles are nearly as popular as bundles including
14 *** service, with approximately *** such bundles in
15 Wisconsin.⁷⁵ If wireless service and wireline phone service were actually
16 perceived as substitutes, consumers would not be interested in bundles that
17 included both.

18

⁷³ SBC acknowledges that its survey firm did not track how many customers asked for – and, therefore, had in mind the same – definition of the term “traditional phone service.” SBC Response to 2-CUB-20.

⁷⁴ For instance, the “SBC Connections” offering provides a \$5 discount on Cingular wireless service when it is added to the bundle.

⁷⁵ Source: SBC Response to 1-CUB-5.

(d) The Claimed Competitors Do Not Offer BLS

Q. The analysis above focused on conditions in the residential market generally, and did not focus solely on competition for stand-alone BLS. Have you also reviewed competitive options to stand-alone BLS?

A. Yes. As I have explained above, SBC is already deregulated in its ability to price packages and bundles of services. The share statistics discussed above assumed that the services offered by SBC's claimed competitors were substitutes for stand-alone BLS. This analysis demonstrated that, even if one assumed that each claimed competitor offered a product that was the "same, equivalent, or substitute" for BLS, the levels of competitive activity claimed by SBC did not constitute effective competition.⁷⁶

It is important to appreciate, however, that a more fundamental flaw exists in SBC's application. That is, the carriers cited by SBC do not offer services that are comparable to the stand-alone BLS that SBC seeks to have deregulated. As the following table clearly shows, these named competitors offers services that

⁷⁶ In effect, after considering the effects of changes in FCC rules, the only carrier with significant share that is likely to remain in the market is TDS Metrocom. As I explained earlier, the activities of this carrier are not evidence of low entry barriers generally and that the Commission would err if it reached a finding of effective competition when the decisions of a single firm could so dramatically alter the competitive landscape.

include the functionality of basic local service as part of a broader package/bundle of services.⁷⁷

SHARE ESTIMATES CONFIDENTIAL

Table 10: Comparing BLS to Lowest Price Service of Named Competitor

Carrier	Share	Monthly Rate	Comment
SBC Basic Local Service		\$12.66	Does not include usage
UNE-Based Entrants			
TDS Metrocom		\$32.05	Requires 2 Year Contract ⁷⁸
Sage		\$33.10	Includes 100 minutes
McLeodUSA		\$18.95	Company for Sale
MCI			Abandoning Market
AT&T			Abandoning Market
Talk			No Longer Accepting Orders
Cable-Based Entrants			
Time Warner		\$44.95	Unlimited Domestic Calling
Charter		\$21.06	

SHARE ESTIMATES CONFIDENTIAL

As Table 10 makes clear, the competitive offerings of SBC's named competitors are not structured to compete with BLS, they are targeted at customers interested in packages and bundles. SBC already has the flexibility to compete fully against such packages and bundles. In the *distinct* market for BLC, SBC effectively faces no competition.

Q. Have you also analyzed the most least expensive wireless plans?

⁷⁷ As I have explained above, SBC's claims rely on the activities of a limited number of carriers. The carriers listed in Table 10 account for 97% of the competitive activity cited by SBC.

⁷⁸ Monthly rate also includes a federal subscriber line charge of \$5.06. TDS Metrocom's website does not disclose other federal charges; however, a TDS sales representative indicated that additional federal charges would add \$8 to \$9 to the monthly bill. I have assumed that TDS Metrocom charges a federal SLC equal to the charge of SBC (\$5.06).

A. Yes. Although I do not believe that wireless service is perceived as a substitute by most consumers (for reliability and other reasons), I did identify the least expensive plans for the larger wireless providers in Wisconsin.⁷⁹ Wireless plans vary by a number of features, but Table 11 is compiled from the most inexpensive monthly plan available.⁸⁰

SHARE ESTIMATES CONFIDENTIAL

Table 11: Least Expensive Wireless Plans of Major Carriers

Wireless Carrier	Relative Share	Monthly Rate	Anytime Minutes
US Cellular		\$39.95	1000
Cingular (SBC)		\$29.99	200
Sprint		\$35.00	300
Verizon Wireless		\$39.99	450
T-Mobile		\$19.99	60

SHARE ESTIMATES CONFIDENTIAL

As Table 11 illustrates, wireless services are generally significantly more expensive than BLS. The pricing of wireless service, combined with its reliability and quality, helps explain why so few customers rely exclusively on the service for access. This is further evidence as to why the Commission should not consider wireless services as a price-constraining substitute to BLS.

⁷⁹ These wireless carriers were identified by the survey performed by SBC (see SBC Response to 3-CUB-7). These five wireless carriers had approximately 90% of the wireless share in Wisconsin (at least as measured by the SBC survey).

⁸⁰ I have not attempted to include each of the options of the competing plans in Table 11 (such as whether night and weekend minutes are included or the rate applied to minutes not included in the plan).

IV. Recommendations

Q. What would be the consequences of the Commission approving SBC's application if there is less than effective competition?

A. As I have noted throughout my testimony, the fundamental product that SBC seeks to have deregulated is stand-alone basic service. In the absence of price-constraining competition, the Commission should expect rate increases up to the point where such increases would prove unprofitable to SBC. At its limit, that would occur as BLS becomes so expensive, even bundles with services generally not desired by the customer become attractive.⁸¹ SBC is primarily interested in selling bundles of services that "drive retention and higher average revenues."⁸² As such, if not limited by price regulation, the Commission should expect price increases designed to make SBC's package offerings relatively more attractive.

Q. Would there be any gain in economic efficiency if the price of stand-alone BLS increased?

⁸¹ The fact that such bundles are not substitutes today does not mean that SBC could not, through increases in the price of BLS, reach a point where such substitution occurs. The point is that the threat of substitution is unlikely to prevent SBC from increasing the price of BLS as it stands today.

⁸² SBC *Investor Briefing*, 3rd Quarter 2004, October 21, 2004.

1 A. No. There would be no efficiency-improving increase in the price of BLS
2 because it does not appear to be priced below cost.⁸³ If BLS was priced below
3 cost, then economic efficiency could be improved by an increase in its price.
4 However, factually the condition does not exist and, as a result, there would be no
5 economic gain from an upward increase in the price of basic local service.

6
7 **Q. Why do you say that SBC would merely increase its prices to encourage**
8 **migration to its packages?**

9
10 A. Packages are clearly the strategic pricing goal for SBC. Already, more than 60%
11 of SBC's consumer lines are part of a bundle,⁸⁴ increasing SBC's revenue per
12 retail consumer line by over 9% in the third quarter (2004) alone.⁸⁵ In Wisconsin,
13 nearly *** *** of the residential customers subscribe to a bundle that
14 combines local service with either long distance, DSL, wireless or DISH TV.⁸⁶
15
16 SBC's strategic pricing behavior is touted in its earnings reports and noted by
17 Wall Street Analysts. During the third quarter of 2004, Banc America reports that
18 SBC increased the average price of its local/long distance bundled by \$5 per
19 month, while simultaneously increasing its ala carte prices to improve "the

⁸³ See SBC Response to PSC 2-12.

⁸⁴ SBC *Investor Briefing*, 4th Quarter 2004, January 26, 2005.

⁸⁵ SBC *Investor Briefing*, 3rd Quarter 2004, October 21, 2004.

⁸⁶ December 2004. Sources: SBC Response to 1-CUB-5, and AET-6.

1 perceived value proposition of bundled services.”⁸⁷ SBC is not only increasing
2 the price of ala carte features,⁸⁸ it is also increasing the effective bundle price by
3 removing features themselves.

4
5 **Q. What should the Commission expect if price caps are lifted from BLS?**

6
7 A. The Commission should expect that SBC would increase BLS rates to encourage
8 migrations to packages that include other services. The upper limit on price
9 would only be where the consumer reaction from the rate increase caused
10 sufficient customers to shift to the packages of others that the net effect would be
11 to lower SBC’s profits.

12
13 As the Commission can see above, however, the number of competitors to SBC is
14 declining, and those that remain do not generally offer services that are
15 comparable to BLS. Thus, the Commission cannot conclude that effective
16 competition would police SBC’s pricing behavior.

17
18 **Q. What do you recommend?**

19

⁸⁷ See “Wireline Services Pricing Update: Pro-Bell Regulatory Shift Filters into Market in 3Q04,” Banc of America Securities, October 8 2004.

⁸⁸ *Ibid.*, page 4

1 A. I recommend that the Commission deny SBC’s request for price deregulation of
2 basic local exchange service in Rate Groups A and B. I do not believe that is a
3 case where the Commission is being asked to make a “close call” – the only
4 meaningful entrant serving residential customers that is likely to continue to do so
5 in the future (TDS Metrocom) does not even offer a service that is comparable to
6 BLS. However, if the Commission does grant such a request, it should only do so
7 with two conditions.

8
9 First, the Commission should delay the effectiveness of any grant in pricing
10 flexibility until the conclusion of a proceeding to fully implement the equivalent
11 to UNE-P as required by §271 of the Act. As I explained earlier, SBC is still
12 required to offer each of the elements of UNE-P under §271 of the Act and to
13 connect those elements together. The principal difference between SBC’s
14 obligations under §251 (which has ended) and §271 (which continues) is one of
15 price. Whereas elements offered under §251 must be priced in accordance with
16 the FCC’s Total Element Long Run Incremental Cost (TELRIC) rules, elements
17 offered in compliance with §271 are judged in accordance with the potentially
18 more liberal “just and reasonable” standard. Furthermore, SBC must connect
19 §251 elements with other wholesale arrangements (including §271 elements), an
20 activity known as “commingling.”⁸⁹ Hopefully, if the Commission is able to

⁸⁹ This reference is intended to highlight an important definitional aspect of federal rules. The term “combining” refers to connecting two elements required under §251 of the Act; the term “commingling” refers to the same action, but involving the connection of a §251 element with some other wholesale arrangement. *See TRO* ¶ 579 (emphasis added):

1 operationalize a just and reasonable §271 UNE-P offering that provides CLECs a
2 meaningful opportunity to compete – which is how such offerings should be
3 reviewed – further decay in residential competition can be prevented.⁹⁰
4

5 Second, if the Commission grants price deregulation for Rate Groups A and B, it
6 should require that SBC make available all of its services – including promotional
7 offerings intended to win customers back from competitors – available throughout
8 each Rate Group. In this way, if competitive conditions do vary geographically,
9 the lowest priced services available in areas with competition must be equally
10 available to customers in other exchanges in the Rate Group.
11

12 **Q. Does this conclude your testimony?**
13

14 **A. Yes.**

By commingling, we mean the connecting, attaching, or otherwise linking of a UNE, or a UNE combination, to one or more facilities or services that a requesting carrier has obtained at wholesale from an incumbent LEC pursuant to any method other than unbundling under section 251(c)(3) of the Act, or the combining of a UNE or UNE combination with one or more such wholesale services.

SBC places great emphasis on a footnote in TRO that it need not “combine” §271 elements (which is true – such elements are not §251 elements. See *TRO*, footnote 1989); its obligation, however, is to “commingle” §251 elements with §271 elements (see *TRO* ¶ 581), which would include loops/switch arrangements analogous to UNE-P. I raise this here not to brief this issue, but to foreshadow the opposition it can expect as SBC seeks to foreclose residential competition.

⁹⁰ I would further recommend that the Commission delay the effectiveness of any lifting of SBC’s price regulation for basic local service until it is clear that the effects of SBC’s prior litigation have been reversed, not to mention until after any subsequent litigation on its §271 requirements have been concluded and all appeals have been exhausted.